



# **REVENUE OPTIONS TO FUND SAFETY NET PROGRAMS**

**Presented by:**

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# **BALANCING THE STATE BUDGET: OPTIONS INCOMPLETE**

- **Spending reductions**
- **Temporary revenue increases**
- **Borrowing, deferrals, and other one-time solutions**

# **WHAT'S MISSING?**

## **TAX EXPENDITURES NOT ON THE TABLE**

**Tax expenditures: Revenue losses attributable to tax law provisions that:**

- **Allow a special exclusion, exemption, or deduction from gross income; or**
- **Provide a special credit, a preferential tax rate, or a deferral of tax liability.**

**The State Budget process does not include oversight of regular review of tax expenditures.**

# **POLICY RATIONALE FOR TAX EXPENDITURES**

- **Equity:** To provide tax relief to taxpayers subject to specific and unusual monetary costs.
- **Behavioral Change:** To provide incentives for taxpayers to change their behavior for a desired policy goal.

# **TAX EXPENDITURES: WINDFALLS WITHOUT MEETING DESIRED POLICY GOALS?**

**Need to treat tax expenditures like direct expenditures, especially when options for balancing the State Budget are limited and/or untenable.**

**Tax expenditures may be:**

- **Repealed**
- **Suspended**
- **Modified**

# **TAX EXPENDITURE EXAMPLE #1: MORTGAGE INTEREST DEDUCTION**

**Still meeting the policy goal of providing an incentive for home ownership?**

## **Potential options:**

- **Suspend the mortgage interest deduction on second homes for all taxpayers.**
- **Modify the mortgage interest deduction debt ceiling on principal residences from \$1 million to \$500,000 for taxpayers with an AGI of \$200,000 and over.**

## **TAX EXPENDITURE EXAMPLE #2: CHARITABLE CONTRIBUTION DEDUCTION**

**Still meeting the policy goal of providing an incentive for making contributions to qualified charitable organizations, especially for high-income taxpayers for whom the original federal deduction was enacted?**

### **Potential option:**

- **Modify the deduction to limit it to 40% of the amount contributed for taxpayers with an AGI of \$200,000 and over.**

## **TAX EXPENDITURE EXAMPLE #3: BASIS STEP-UP ON INHERITED PROPERTY**

**Still meeting the policy goal of avoiding double taxation, whereby inherited property and capital gains both are subject to tax?**

### **Potential option:**

- **Repeal the stepped-up basis for California property inherited from deaths for all taxpayers.**



# REVENUE ESTIMATE FOR POTENTIAL OPTIONS

	2012	2013	2014	Affected Taxpayers
<b>Mortgage interest deduction: second homes</b>	<b>\$321M</b>	<b>\$62M</b>	<b>\$58M</b>	<b>All</b>
<b>Mortgage interest deduction: principal residences/\$500K</b>	<b>430M</b>	<b>372M</b>	<b>440M</b>	<b>AGI: \$200K+</b>
<b>Basis step-up on inherited property</b>	<b>110M</b>	<b>220M</b>	<b>410M</b>	<b>All</b>
<b>Charitable contribution deduction: 40%</b>	<b>430M</b>	<b>463M</b>	<b>518M</b>	<b>AGI: \$200K+</b>
<b>TOTAL:</b>	<b>\$928M</b>	<b>\$1.1B</b>	<b>\$1.4B</b>	

# ISSUES FOR CONSIDERATION

- **2/3 vote required in each house of the Legislature to repeal, suspend, or modify tax expenditures.**
- **Repealing, suspension, and modification of state tax expenditures may result in lack of conformity with federal law.**
- **Evaluating tax equity pursuant to proposals to repeal, suspend, and/or modify tax expenditures.**
- **Evaluating behavioral change pursuant to proposals to repeal, suspend, and/or modify tax expenditures.**